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UNCLAS SECTION 01 OF 02 ANKARA 007000

SIPDIS

SENSITIVE

TREASURY FOR INTERNATIONAL AFFAIRS - MMILLS AND RADKINS
NSC FOR BRYZA AND MCKIBBEN

E.O. 12958: N/A
TAGS: EFIN TU
SUBJECT: JUST IN CASE: NO NEED FOR TURKISH TREASURY TO BORROW UNTIL MID-JANUARY

REF: A. ANKARA 6947

¶B. ANKARA 6700

¶1. (SBU) Summary: Turkish Treasury officials tell us they have prepared for the possibility of a worse-than-expected EU scenario by obviating the need to borrow for the coming month. More broadly, in 2005 Treasury is targeting an increase in the average maturity of its domestic market Turkish lira debt from 14 to 17 months. Though Treasury has reduced its exposure to foreign exchange risk over the past year, it will not further reduce the share of foreign exchange-denominated debt going forward, as it balances exchange rate risk with the cost saving from much lower interest rates on foreign exchange borrowings. End Summary.

No Need to Borrow Right After December 17 EU Decision:
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¶2. (SBU) Treasury officials have confirmed to us that they will not need to issue any significant quantity of new debt until around January 20. In the event that EU-related news roils Turkish financial markets, it will therefore be a secondary market--rather than a primary market--phenomenon, posing no immediate risk to GOT finances. The next significant borrowing on the Treasury calendar does not come until mid-January.

Maturity Lengthening Targeted for 2005:

¶3. (SBU) For 2005, Treasury officials confirmed that they have targeted a lengthening of domestic maturities from the current 14 months to 17 months, for debt issued to the domestic market, excluding the so-called "non-cash debt" held by public institutions. Analysts had criticized Treasury over the past year for not making more of an effort to lengthen maturities, so as to reduce the risk of problems rolling over Turkey's massive short-term debt. Many analysts believe that Treasury has not done so in order to avoid being blamed later for being saddled with high-interest debt in a falling interest rate environment.

¶4. (SBU) In a meeting with a visiting US Treasury official and econoff, Turkish Treasury's domestic debt manager Volkan Taskin claimed that Turkish Treasury's preference would be to issue more long-dated paper, but that market conditions have stood in the way. Turkish banks, who are both the primary dealers of Turkish domestic debt and the principal holders, have an extremely short-dated deposit base, such that even buying one-year Turkish lira paper leads to a substantial asset-liability maturity mismatch, since it is largely funded by 3 month deposits. Individual investors prefer even shorter (up to 6 month) paper, with only foreign investors interested in buying significant quantities of paper with a maturity of 18 months or more. The most liquid bond is usually of about 18 months maturity (referred to as the benchmark bond) because the 18 month maturity interests both domestic banks and foreign investors.

¶5. (SBU) In October, Treasury took a significant step towards creating a market for longer-dated paper by issuing a 3-year bond. Until this issuance, the Treasury had never issued longer than 2-year TL paper in recent years, and usually limited itself to new benchmark bond issuances at about 18 months maturity. It is a small issue ($393 million), however, that will not make a big impact on the average maturity of Treasury's huge ($153 billion) domestic debt. Taskin said Treasury estimates that 85 or 90 percent was purchased by foreign investors. Two different London-based investment bankers told econoffs they had been urging Treasury to issue 3-year paper for some time and had virtually guaranteed their own banks would find buyers for it. Taskin said once rates fell further and the 3-year paper began to trade at a premium, Treasury planned to reissue the same instrument several times in 2005. He doubted Treasury would issue longer than 3-year domestic lira bonds until at least the second half of 2005.

Treasury Comfortable With Current Foreign Exchange Profile:

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¶6. (SBU) Over the past year, Treasury has substantially reduced the share of its total debt--both foreign and domestic--which is either denominated in or indexed to a foreign currency. For 2004, U/S Canakci told us Treasury had targeted an 80% rollover rate for its domestic foreign exchange debt. As of October, domestic debt is only 19% foreign exchange-linked or denominated, according to Taskin, a substantial fall over the course of the year. Total debt (i.e. external and domestic) is now 56% lira-denominated and 44% foreign exhange-denominated or -linked, an improvement from about 50-50 in the fall of 2003.

¶7. (SBU) Going forward, however, Treasury has decided the costs of further reducing foreign exchange-denominated debt outweigh the risk of a depreciation of the lira. With dollar and euro rates currently 17 percentage points cheaper than lira rates, Treasury has decided to roll over 100% of its foreign exchange domestic debt in 2005. Moreover, since Treasury can issue longer-maturity paper in the domestic market if it is denominated in foreign exchange, continuing to issue foreign-exchange denominated paper helps lengthen average maturities and reduce rollover risk.

Falling Dollar Helpful:

¶8. (SBU) Taskin confirmed that the fall of the dollar against the lira is helpful to the Turkish Treasury's debt position. Though Turkey's external debt is only 44% in dollars, if one adds the dollar component of the $20 billion SDR-denominated debt to the IMF, the external debt is more than half dollar-linked. More critically, domestic foreign exchange-denominated and indexed debt is almost entirely in dollars, according to Taskin, meaning that a falling dollar is clear net positive for Turkey's debt situation.

EDELMAN